the underlying costs can assist regulators in identifying the need, as it should then appear, for universal service support.[33]

V. Administrative Support Mechanisms

The 1996 Act states that "[a]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service."[34] Accordingly, the NPRM seeks comment on how financial responsibility should be divided between interstate telecommunications carriers and intrastate carriers for costs associated with universal service support and who should administer the distribution.[35]

A. The Responsibility for Funding Universal Service Should be Broadly Shared

In order to allocate the responsibility of funding universal service support equitably, two changes must take place. First, general, non-targeted support for local exchange access should be eliminated. Second, to the extent that targeted support is necessary, it should be based upon a value added assessment on all industry participants.

1. Targeted Support Programs are a More Efficient and Effective Means of Achieving Universal Service

As discussed above, the CCLC-funded general support mechanism should be eliminated as the LEC's intrastate telecommunications rates are realigned with the underlying costs.

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[33] The need for a subsidy may be reduced to the extent rate rebalancing has the desired effect of reducing required support levels.

[34] 1996 Act sec. 101(a), §254(b)(4).

[35] NPRM, para. 117.

In contrast, targeted support programs are more efficient programs that tend to focus on specific needs of a community or class of consumer directly. For instance, lifeline assistance programs target subsidies for low-income households by providing reduced installation and recurring rates for network connectivity.

Moreover, targeted subsidies are more effective in achieving universal service goals because with targeting, the same degree of connectivity and ubiquity can be achieved at a small fraction of the costs. However, even targeted subsidies can have an undesirable effect of rewarding inefficiencies on the part of the incumbent provider. Thus, where targeted subsidies are warranted, the responsibility of contributing to the fund must be accomplished in a competitively neutral manner.

2. Targeted Support Should be Based on a Value Added Assessment on all Telecommunications Providers

It is a difficult task to allocate the responsibility of funding universal service equitably because of the existing service-specific universal service funding system. Currently, the universal service funding mechanism relies upon specific services and service elements. Thus, if a provider does not utilize LEC interstate switched access minutes, that provider does not contribute to the funding process. Despite these disparities, the best possible approach for funding targeted universal service support is to impose a uniform percentage contribution based upon the value added by each industry participant.

"Value added" is the total gross revenues of a provider minus payments for common carrier services furnished by other entities subject to the universal service funding obligation and which themselves constitute part of the providers' gross common carrier revenues. Under this approach, the total universal service funding "budget" or "contribution" requirement would be divided by the total industry-wide value added product to produce a contribution rate. This contribution rate would, in turn, be applied to each industry participant on the basis of its respective value added.[36]

Payments made to the USF would also be deducted from the value added calculation. In addition, monies drawn from the USF would be included within the gross revenues of the recipient entity. Thus, assuming that USF clears to zero in each accounting period, the transfer of universal service funds from payor to payee would not affect the gross industry value added amount.

B. State Commissions Should Administer the Distribution of Universal Service Funds

Once the Commission has allocated interstate high cost assistance among the states, state regulatory commissions should be authorized to administer and control the distribution of funds to potential local service providers in its state consistent with the distribution of intrastate universal service funds. States are in a better position to establish distribution plans that will accommodate the market conditions in their state.

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[36] See Appendix A at 26-27 for an illustration of this approach.

Based on their extensive knowledge about each company providing local exchange service in the state and the level of competition in the local market, each state commission is in the best position to adapt the high cost assistance mechanism to fit its needs. In particular, states are likely to be more familiar than federal policymakers with details of the factors influencing universal service within that state, including the rate design of incumbent LECs, the network capabilities of the LECs, the geography of the state and the socioeconomic composition of the state's households. In addition, state commission resources and personnel are better suited to administer support programs on a local level. The great diversity of needs in different areas of the country demand that input on the distribution of funds be obtained at state and local levels.

Although states should be given the authority to formulate and execute high cost funding distribution plans, the Commission should maintain a supervisory role over the distribution of interstate funds. Certain state regulations may act as a barrier to the development of a workable high cost assistance distribution plan in the interstate market. Moreover, it is both necessary and in the public interest to ensure that funds are consistently distributed on a national level. Just as federal policies will influence the distribution of high cost support at the state level, state policies may affect federal developments. Thus, the regulations established to distribute high cost funds must be implemented consistently on both the federal and state level. Supervision will also be necessary to ensure that state

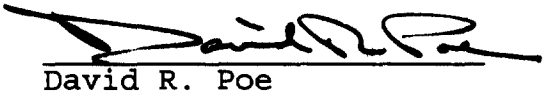
plans do not act as de facto barriers to competition in violation of the 1996 Act.

Conclusion

As described herein, TW Comm generally supports the recommendations that the Commission has proposed in its effort to implement the mandates of the 1996 Act.

Respectfully submitted,

TIME WARNER COMMUNICATIONS HOLDINGS, INC.

By: 

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Date: April 12, 1996

CERTIFICATE OF SERVICE

I, Catherine P. McCarthy, hereby certify that on this 12th day of April, 1996, a true copy of the foregoing Comments filed by Time Warner Communications Holdings, Inc., were sent via First Class Mail, Postage Prepaid, or Hand Delivered, upon each of the parties on the attached Service List.

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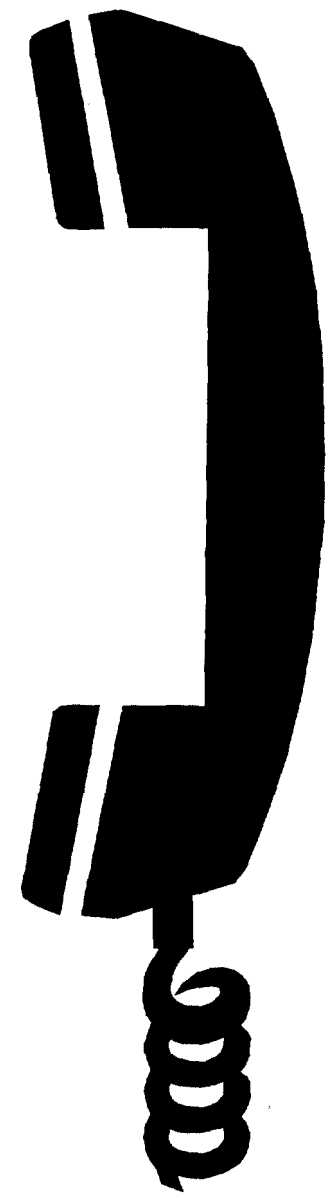
Funding Universal Service:

Maximizing Penetration and Efficiency in a Competitive Local Service Environment



A Time Warner Communications Inc.

Telecommunications Policy White Paper

TIME WARNER
COMMUNICATIONS

FUNDING UNIVERSAL SERVICE:

Maximizing Penetration and Efficiency in a Competitive Local Service Environment

A Time Warner Communications, Inc.
Telecommunications Policy White Paper*

This is the first in a series of Time Warner Communications, Inc. white papers on current issues of national telecommunications policy. As a new, competitive provider of local telephone service, Time Warner is committed to supporting and expanding the availability of affordable universal telephone service in all parts of the nation and to all of its citizens. Competition in the local telephone market is fully consistent with, and will contribute to, this long-standing national policy goal. The telecommunications legislation recently passed in both houses of Congress recognizes that it is now time to permit the energy of competition and the excitement of technological revolution to redefine telecommunications services. Nevertheless, incumbent local telephone monopolies persist in reviving long-settled arguments that competition and universal service cannot coexist. If there is any risk to universal service, it is that the incumbents' rhetoric will be believed and that the many benefits of competition will be delayed or foreclosed. In this paper, we identify principal policy and economic goals of Universal Service and propose funding principles most likely to achieve those goals with the least economic and market distortions.

-- Paul B. Jones, Senior Vice President, Regulatory and Public Policy,
Time Warner Communications

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* This *Time Warner Telecommunications Policy White Paper* has been prepared under the direction of Donald Shepheard, Regulatory Director for Time Warner Communications, with the assistance of Dr. Lee L. Selwyn and Susan M. Baldwin, respectively President and Vice President of Economics and Technology, Inc., Boston, Massachusetts 02108.

Table of Contents

Executive Summary

As a new, competitive provider of local telephone service, Time Warner is committed to supporting and expanding the availability of affordable universal service in all parts of the nation and to all of its citizens. The presence of competition in the local telephone market is fully consistent with this long-standing national policy goal: By expanding the scope of available services and capabilities and by improving the overall efficiency with which such services are provided to the public, the introduction of competition into the local telecommunications market will contribute significantly to maximizing the general availability of advanced telecommunications services to all communities and for the support of an ever-expanding variety of economic, educational, entertainment, and social activities. The entry of competition does not and should not *create* a "universal service problem:" indeed, it will help to maintain this nation's worldwide leadership in assuring available and affordable public telecommunications services to all segments of the population.

There is, however, little dispute that, in a multi-vendor, competitive telecommunications market environment, the responsibility for financially supporting the universal service goal should be shared broadly, both across all vendors and across all sectors of this increasingly complex industry structure. Where there is considerable debate - and disagreement - is, not surprisingly, in three key areas:

- How much funding of universal service will be required to satisfy national telecommunications policy goals?

- Which entities should be eligible to draw funds from the universal service funding mechanism, and under what circumstances?

- Which entities should be required to participate in providing these funds, and how should their respective contributions be determined?

Although the respective interests of the various stakeholders clearly will effect each's position on these issues, all generally agree that larger public interest goal is to assure the desired level of connectivity to the public telecommunications network while minimizing to the greatest extent possible any economic or market distortions that might arise through interference with free market mechanisms. This paper will address each of these three and related policy questions, and offer specific recommendations for their resolution in a competitively-neutral manner.

The scope of "universal service" should be narrowly defined so as to maximize competitive opportunities and minimize the extent of required financial support.

This nation has long had an unwavering commitment to achieving ubiquitous and universal connectivity, at affordable prices, to the public telecommunications network. At the same time, that commitment is not without limits, and as such has generally been directed at three principal policy areas:

(1) Assuring general *affordability* of basic network access across all segments of the population;

(2) Providing explicit subsidy support for targeted low-income households to assure their connectivity to the public switched network; and

(3) Through broad pooling and rate averaging, providing support for communities that may be relatively costly for a local telephone company to serve.

The "Universal Service" objective has been, and should continue to be, confined generally to basic *analog voice* connectivity of *residential* consumers to the public switched telephone network (PSTN), along with *access* to long distance networks, emergency response (911) services, directories and directory assistance. The broader the scope of universal service and hence the more financial support that is earmarked for it, the less affordable all *other* services (i.e., those which are then required to provide that financial support) necessarily become. The incumbent telcos argue that emerging competition in those segments that have traditionally supported below-cost basic exchange access will put considerable stress on those funding sources, both because some customers may find competitive and/or technological alternatives that effectively escape them, and because carriers have sought to reduce and even to permanently eliminate such subsidization. The solution is a "zero-base" approach to continued funding of universal service.

The "affordability benchmark." For purposes of constraining the extent to which any affirmative financial support for universal service is required, service should be deemed "affordable" if its price is set at or below the highest rate level applicable for any exchange within a given jurisdiction for which residential penetration is within five percentage points of the jurisdiction-wide average. Only where the (unsubsidized) cost of serving an area exceeds this "affordability benchmark" level will the incumbent local exchange carrier become eligible to apply for possible "high-cost" support.

Competitive access to "high-cost" areas. Where the incumbent elects to seek high-cost funding for a particular area, it will be required to subject the cost conditions it claims to confront to competitive marketplace forces. This would be accomplished through an auction in which potential competitors would be invited to "bid" against the incumbent for such funding. Only the low bidder, which may not be the incumbent LEC, would be eligible to draw funds.

Low-income households. The use of income-targeted support mechanisms - such as the Lifeline and Link-up programs - is well established, and should be continued. However, qualifying customers should be permitted to take service from any certified local carrier; hence, all low-income support mechanisms should be made "portable" and available to whichever carrier actually provides the service.

Contributions to the universal service funding mechanism should be in proportion to the net "value added" by each telecommunications carrier entity.

Broad industry participation in any universal service funding program is essential in order to maximize competitive neutrality and minimize any economic distortions that may be created by the funding process itself. This can best be achieved through a contribution system based upon *net value added* by each qualifying entity. Net value added, for this purpose, is defined as gross common carrier revenues less payments for common carrier services furnished by other entities subject to the universal service funding obligation and which themselves constitute part of the providers' gross common carrier revenues. All entities that are required to participate in the funding program are eligible, on a competitively neutral basis, to draw from the fund in order to support qualifying high-cost and low-income services.

Conclusion

Incumbent telecommunications monopolies have been raising concerns about the impact of competition upon universal service - and warning of its imminent demise - for at least three decades. Despite these often-repeated admonitions and scare-tactics, penetration rates are up, usage of both local and long distance services is up, and basic telephone service is more affordable today than at any other time in the past. By any reasonable measure, universal service has been achieved in the United States, and its preservation is not jeopardized by further erosion of the telecommunications monopolies.

Although universal service is and should remain a central focus of US telecommunications policy, resolution of all pending issues and concerns should not be allowed to slow or complicate the development of an effectively competitive local telecommunications market. LEC shareholders clearly do not see LEC claims as to the adverse financial consequences of

competition as representing anything more than regulatory posturing, and such dire predictions deserve no more credence among regulators than among investors.

In this paper, we outline a program to both minimize the extent to which explicit universal service support will be needed and to provide a process for obtaining such support in the most efficient, competitively neutral manner. In time, the need for such funding should diminish as competition and technology work to bring affordable local telephone service to those parts of the country that are today subject to unusually high costs and rates. LEC concerns, to the extent that they have any legitimacy at all, are at best transitional, and must be addressed with the "end state" clearly in sight.

I. Universal Service in a multi-vendor, competitive market environment

In crafting universal service policies and programs, regulators should seek to minimize economic and market distortions

There is little dispute that, in a multi-vendor, competitive telecommunications market environment, the responsibility for financially supporting the universal service goal should be shared broadly, both across all vendors and across all sectors of this increasingly complex industry structure. Where there is considerable debate - and disagreement - is, not surprisingly, in three key areas:

- How much funding of universal service will be required to satisfy national telecommunications policy goals?
- Which entities should be eligible to draw funds from the Universal Service funding mechanism, and under what circumstances?
- Which entities should be required to participate in providing these funds, and how should their respective contributions be determined?

It would be a gross understatement to suggest that the respective interests of the various stake-holders color each's position on these issues. But the larger public interest goal is to assure the desired level of connectivity to the public telecommunications network while minimizing to the greatest possible extent any economic or market distortions that might arise through interference with free market mechanisms. We believe it is possible to craft a competitively-neutral universal service policy and funding process that will balance these sometime conflicting concerns. This paper will address each of these three related policy questions, and offer specific recommendations for their resolution in a competitively-neutral manner.

Competition and universal service are compatible goals

The goals of competition and universal service are often portrayed as somehow in conflict: Incumbent telephone companies (LECs) have claimed, for example, that competition erodes subsidies and thereby frustrates their ability to furnish basic network connectivity at "affordable" prices. In fact, not only is the development of a competitive marketplace fully compatible with universal service goals, in the modern context it is an *essential element* of universal service policy.

Competition will stimulate efficient behavior and will drive prices down toward the (then lowered) cost levels. Competition will encourage greater efficiencies among the LECs and offer business

and residential consumers choices among alternative providers. Finally, competition and the efficiencies it will engender will reduce the ongoing need for any general subsidy of residential service. The pro-competitive telecommunications legislation passed in more than a dozen states this year and in the United States Congress constitute a first and all important step in making competition a reality. However, much work remains in developing a competitive regulatory policy framework. As an over-arching theme in completing that work, we believe the way to achieve competition and assure universal service is to ensure fair, cost-based interconnection with elements of the LECs' local networks. The development of a universally available, advanced telecommunications network depends critically on the nation's success in eliminating barriers to competition and assuring cost-based connectivity among competing telecommunications service providers.

The definition of universal service has evolved, but the commitment to universal service has been consistently reaffirmed by state and federal regulators

The *Communications Act of 1934*[1] and any number of state statutes and regulatory rulings at both the state and federal levels have continuously and consistently reiterated this nation's commitment to ubiquitous and universal connectivity to the public telecommunications network. At the same time, that commitment is not without limits, and as such has generally been directed at three principal policy areas:

(1) Assuring general *affordability* of basic network access across all segments of the population (rate design);

(2) Providing explicit subsidy support for targeted low-income households to assure their connectivity to the public switched network (lifeline); and

(3) Through broad pooling and rate averaging, providing support for communities that, for one or more reasons,[2] may be relatively costly for a local telephone company to serve (high cost funding).

Only certain basic network access and connectivity services have traditionally been viewed as falling within the scope of universal service; indeed, it is a long-standing policy and business reality

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[1] *Communications Act of 1934*, 47 U.S.C. 151.

[2] These could include low population density over a large service area, unusual terrain or environmental conditions, geographical remoteness, or any combination thereof.

that those services which do not qualify for universal service treatment are often utilized as a source of financial support for those that do.[3]

At the present time, the "Universal Service" objective has generally been confined to basic *analog voice* connectivity to the public switched telephone network (PSTN), and has thus embraced primarily *residential* local exchange access ("dial tone line") service. In some cases, a block of local usage may be included within the "basic residential service" package.[4] For example, telecommunications between points outside of the user's immediate vicinity ("non-local" calls) are not now, and have never been, considered as part of universal service. In fact, rates for such calls were historically set so as to provide funds to permit local telephone companies to offer basic local residential exchange service (which has typically been considered as falling within the scope of a universal service baseline) to customers at less than the full cost of providing it. Not surprisingly, basic local residential exchange service has typically been considered as falling within the scope of a universal service baseline. Most vertical service features, such as "Call Waiting," "Caller ID," and "Call Forwarding," have not been similarly included within that baseline, and in fact are typically priced well in excess of their direct cost in order to help support affordable basic service.

The universal service definition has changed considerably over the past two decades. For example, since the mid-1980s, several elements of "universal service" have been stripped away, such as the primary telephone instrument, customer premises inside wiring, directory assistance, and in some cases even local calling. Some states, on the other hand, have augmented the baseline service by including Touch Tone calling as a standard feature.[5] As of this writing, there are no jurisdictions in which advanced services such as ISDN or broadband connectivity have been incorporated within the universal service baseline, although several have required that such services be priced at "affordable" rather than at "premium" rates.[6]

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[3] Under rate of return regulation, regulators required LECs to design their rates so as to generate substantial "contribution" from discretionary and premium services and features - long distance, custom calling services, touch tone, unlisted numbers, various business telecommunications services, and (prior to its deregulation) customer premises equipment - and to set rates for basic residential exchange service *residually*, requiring only that it generate sufficient revenue to close the gap between the contribution-producing services and the aggregate "revenue requirement" of the LEC. LECs have themselves supported and benefitted from such pricing strategies, because (1) the higher-priced premium and discretionary services generally experienced higher demand growth than the residually-priced basic service, and (2) LECs encountered far less regulatory resistance to requests for rate increases when these were targeted principally at premium and discretionary services.

[4] The inclusion of a block of local usage as part of the "universal service" commitment varies from state to state. In some states basic local usage, like basic local access, is the recipient of support from other services and service elements. In others, only the "dial tone line" is subsidized, with all usage, whether furnished on a flat-rate or a measured basis, priced at no less than long run incremental cost.

[5] *In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers; and Related Matters*, California PUC Decision No. 90-11-058, 38 CPUC 2d 269, November 21, 1990.

[6] *See*, e.g., Massachusetts DPU 91-63 (February 7, 1992).

The problem, of course, is that the broader the scope of universal service and hence the more financial support that is earmarked for it, the less affordable all *other* services necessarily become (i.e., those which are then required to provide that financial support). The entry of competition into those segments that have traditionally supported below-cost basic exchange access threatens to put considerable stress on those funding sources, both because some customers may find competitive and/or technological alternatives that effectively escape them.

A "zero-base" approach to continued funding of universal service should be pursued. Rather than extrapolate from tradition (i.e., continue to do things because "that's the way they've always been done"), a new scope, definition, and most importantly a *budget* for continued universal service support should be established based upon compelling national needs and the most efficient means for achieving them.

II. Universal service support mechanisms

Policymakers should examine the nature of the various existing sources of universal service support and then determine how, if at all, each will be affected by local exchange competition

Up to now, the sources of support for universal service have come primarily through other LEC services priced well in excess of cost, and through certain explicit charges imposed by LECs upon long distance carriers expressly for this purpose. The principal sources of subsidy that exist at the present time consist of:

- Yellow pages advertising revenues;
- Interstate (and, where applicable, intrastate) Carrier Common Line (CCL) revenue;
- Interstate/intrastate switched access/transport services priced in excess of cost;
- Local and intraLATA toll usage services priced in excess of cost;
- Vertical service features priced in excess of cost; and
- Universal service fund.

Although some of these traditional subsidy sources may be affected by the onset of local competition, others, such as yellow pages revenues, are distinctly not materially "at risk." In formulating a universal service support policy for a future competitive local services environment, we should first understand the nature of each of these existing sources of support and to determine how, if at all, each will be impacted by the entry of competing local carriers.

Yellow pages. In most states, Yellow Pages directory revenues have long been used as a source of financial support for below-cost pricing of basic local exchange telephone service,

principally (but not exclusively) the residential "dial tone" exchange access line. The specific *pricing* of Yellow Pages listings and display advertisements is typically not subject to review or regulation; LECs are free to set these rates at whatever level the market will bear.[7] However, with respect to Yellow Pages revenues and costs *in the aggregate*, these are, in most jurisdictions, included within the LEC's intrastate revenue requirement.[8]

The Yellow Pages business is extremely profitable. In fact, the specific contribution-generating role of the Yellow Pages business was addressed and recognized in the MFJ consent decree that broke up the Bell System. When the terms of the MFJ were initially announced on January 8, 1982, the Yellow Pages were to be assigned not to the Bell Operating Companies (BOCs), but instead to AT&T. In the *Tunney Act* proceeding that followed the initial settlement agreement by AT&T and the Department of Justice, the BOCs, many state public utilities commissions, and the National Association of Regulatory Utility Commissioners argued strongly for the retention of the Yellow Pages business by the BOCs *expressly because of the enormous amount of revenue that was contributed by Yellow Pages to support basic exchange access services*. In response to these arguments, Judge Greene determined that the Yellow Pages should be retained by the BOCs. In an Order adopting the MFJ, issued August 24, 1982, he concluded that Yellow Pages "provide a significant subsidy to local telephone rates [that] would most likely continue if the [BOCs] were permitted to continue to publish the Yellow Pages."[9] He went on to state:

> The loss of this large subsidy would have important consequences for the rates for local telephone service. For example, the State of California claims that a two dollar increase in the rates for monthly telephone service would be necessary to offset the loss of revenues from directory advertising. Other states assert that increases of a similar magnitude would be required.

Clearly, the existing inclusion of Yellow Pages revenues as a source of universal service support was the result of an affirmative judicial finding that the profits from the publication of these directories should be used to defray a portion of the cost of providing basic local telephone service. The entry of competition in the provision of local exchange service does not adversely impact aggregate yellow pages revenues, nor does it pose any competitive challenge to the established

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[7] In fact, this condition has in some cases been confirmed by legislation. *See*, e.g., Cal. Pub. Util. Code § 728.2.

[8] In some states, LECs have succeeded in removing yellow pages revenues altogether from their traditional support role, or in limiting the aggregate amount of such revenues that will be available for this purpose. Where this has occurred, there is less overall contribution available to support below-cost pricing of the universal service baseline, but this "problem" is of course of the LEC's own doing. Clearly, before new contribution burdens are imposed upon competing local carriers and others, LECs should be required to *re-include* their substantial yellow pages profits within the overall support funding mechanism.

[9] *U.S. v. AT&T*, 552 F. Supp. 131, 193-194 (D.D.C. 1982).

supremacy of the incumbent LEC's yellow pages.[10] Nothing has changed since the adoption of the MFJ to warrant a change in the traditional role of yellow pages in providing support for universal service. Thus, before new contribution burdens are imposed upon competing local carriers and others, LECs should be required to include (or re-include) their substantial yellow pages profits within the overall support funding mechanism.

Carrier Common Line (CCL) revenue. The Carrier Common Line Charge (CCLC) that is applied for all interstate and for many intrastate switched access minutes was explicitly established as a general support mechanism, to recover that portion of the non-traffic-sensitive (NTS) common line revenue requirement that is not otherwise recovered through end user charges. Interstate CCL revenue contributes approximately $2 per residential access line per month. While the incumbent LEC will technically "lose" a portion of this revenue when one of its subscribers elects to take service from a competing local service provider, the incumbent will also shed some portion of NTS costs, and the new provider will itself be able to impose switched access charges of a comparable magnitude upon interexchange carriers for access to its customers. Consequently, just as the CCL revenue is intended to support the provision of residential access at "affordable" prices when provided by the incumbent LEC, a competing carrier's ability to collect the equivalent charges will similarly permit it to maintain affordable rates for its own residential service offering, thereby "levelling," to some extent, the "playing field" as between it and the incumbent.[11] Accordingly, no measures are required or appropriate to "replace" any decreases in LEC carrier common line revenues that may result from the entry of new local providers.[12]

Switched access/transport services priced in excess of cost. While the CCLC element of the switched access charge structure is expressly intended to provide support for universal service, the so-called "traffic-sensitive" (TS) local switching and transport elements of the switched access rate structure were supposedly set at their corresponding traffic-sensitive cost. While many had long believed that these rates were actually set far in excess of cost, that condition has now been

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[10] In fact, although the yellow pages business has been technically open to competition since the break-up of the Bell System, virtually every one of the numerous attempts to enter this lucrative market have been met with total failure. For example, Southwestern Bell's directory publishing affiliate tried to compete with New York Telephone by offering its own Manhattan Yellow Pages. Donnelley Directory, a division of the R. H. Donnelley Company, a firm that had long been in the business of publishing and marketing Yellow Pages directories under contract with Bell and non-Bell local telephone companies, attempted to enter the Yellow Pages business in several markets. Significantly, and notwithstanding the fact that these ventures were initiated by well-financed firms with considerable experience in and knowledge of the directory publishing business, none of them has succeeded in making any consequential inroads into this market.

[11] Note, incidentally, that this is not the case with respect to yellow pages revenues. Here, the entire subsidy will flow to the incumbent, and none of it will be available to competing local carriers unless some explicit action is adopted to make such subsidies "portable" with respect to the service provider. We discuss this specific issue in more detail below.

[12] We recognize that the continued assessment of the CCLC upon the cost of long distance service constitutes a market distortion to the true costs of providing local and long distance services. This distortion is discussed below in conjunction with the subscriber line charge.

indisputably confirmed by recent FCC and LEC initiatives to restructure switched access charges in light of growing competition in the access services market.[13] However, like the CCLC, loss of these revenues to competing local providers merely provides the new local service entrants with the same ability to maintain the affordability of their own end user rates as is available to the LEC. As such, no compensatory payment mechanism is either necessary or appropriate.

Local and intraLATA toll usage services priced in excess of cost. As with both the CCLC and the TS elements of switched access, local usage and intraLATA toll services have long provided a source of support for pricing the dial tone line below its fully allocated costs. In recent years, regulators in a number of states have adopted "rate rebalancing" programs whose effect is to decrease these usage-sensitive rates and to raise the monthly end user dial tone line rate. As such, the relative importance of these charges in the overall LEC revenue structure is less than it had been in the past. Moreover, there is wide variation in the share of aggregate LEC revenues that is represented by such charges. LECs that utilize flat-rate local service rate plans, and that have established large flat-rate local calling areas (e.g., BellSouth, Southwestern Bell, and US West) are somewhat less exposed to a loss of such usage revenues to local and intraLATA competitors than are LECs (such as NYNEX, Pacific Telesis, Bell Atlantic and Ameritech) that have traditionally relied upon above-cost pricing of these services as principal revenue components. New entrants, on the other hand, are required to accept the prevailing LEC rate structure, and will themselves be constrained to establish comparable rate and revenue structures in the markets in which they compete. Accordingly, there should be no specific requirement on the part of new carriers to offset LEC revenue losses with respect to these services.

Vertical service features priced in excess of cost. Finally, a major source of support for "low" dial tone line rates comes from above-cost pricing of vertical services and features. These include touch tone dialing, call waiting, unpublished number charges, and various custom calling and "CLASS" features like Caller ID, Call Return, etc. While LECs may characterize revenues from vertical services as supporting low dial tone line rates, the decision to offer these features as separately-priced rate elements, rather than to include some or all of them within the scope of the basic service "package," is likely more the result of marketing judgments

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[13] The restructuring of switched access local transport rates from the "common transport", "equal charge per minute of use" format required by the MFJ to a non-usage sensitive "dedicated transport" model resulted in sharp decreases in overall switched access rate levels, so much so that LECs argued for and were granted so-called "Residual Interconnect Charges" ("RICs") to make up for the revenue shortfall. *See, Transport Rate Structure and Pricing*, Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 91-213, 7 FCC Rcd 7006 (1992) (*Transport Order); Transport Rate Structure and Pricing*, CC Docket No. 91-213, FCC 93-366, First Memorandum Opinion & Order on Reconsideration, released July 21, 1993 (*First Reconsideration Order*); and *Transport Rate Structure and Pricing*, CC Docket No. 91-213, FCC 93-403, Second Memorandum Opinion and Order on Reconsideration, released August 18, 1993 (*Second Reconsideration Order*); *In the Matter of the NYNEX Telephone Companies Petition for Waiver, Transition Plan to Preserve Universal Service in a Competitive Environment, Memorandum Opinion and Order*, FCC 95-185, May 4, 1995 ("NYNEX USPP Order").